STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-451

September 29, 1997

BANGOR HYDRO-ELECTRIC COMPANY,
Petition for Approval of Electric
Rate Stabilization Agreement

ORDER
(PART II)

WELCH, Chairman; NUGENT and HUNT, Commissioners

I. SUMMARY

In this Order, we issue a certificate of approval for the electric rate stabilization agreement (Agreement) submitted by Bangor Hydro-Electric Company (BHE) in this proceeding. Our approval of the Agreement is conditioned on charter municipalities' commitments, by the closing of the transaction, to provide 101,000 tons of waste per year through 2018 at specified tipping fees and on contract language providing for a collective commitment of charter municipalities to deliver 155,000 tons of waste annually.

II. BACKGROUND AND DESCRIPTION OF AGREEMENT

On July 14, 1997, BHE filed, pursuant to 35-A M.R.S.A. § 3156, a petition for approval of the Agreement and the prefiled testimony of Frederick Samp and Calvin Bell. The Agreement is intended to lower BHE's costs related to its purchase power agreement (PPA) with the Penobscot Energy Recovery Company (PERC). The PPA, which terminates in 2018, obligates BHE to purchase the output of PERC's 21.16 MW waste-to-energy facility in Orrington, Maine; the plant is a qualifying facility (QF) as defined in 35-A M.R.S.A. § 3303.

The Agreement is among BHE, PERC and the Municipal Review Committee (MRC). The MRC is an organization that represents municipalities (referred to as "charter municipalities") that currently have long-term contracts with PERC. The contracts include waste tonnage commitments, a tipping fee formula, and a revenue sharing arrangement under which the charter municipalities and PERC receive one-half of PERC's net revenues after all costs (including a return on PERC's investment). These contracts expire in 2004.

Under the Agreement, as originally filed, PERC refinances its existing bonds and extends its debt maturity from 6 years to 20 years by issuing approximately $50 million in new debt through the Finance Authority of Maine (FAME). BHE pays PERC $8 million at closing with an additional $2 million by 2002; these amounts are placed in a PERC reserve account.[1] BHE also issues 2 million stock warrants (1 million to PERC and 1 million to the MRC) that entitles the holder of each warrant to purchase one share of stock at $7 per share; the warrants expire 10 years from the date of issuance and are exercisable in specified maximums over that time.[2] Additionally, BHE pays the MRC $45,000 a year (escalated at inflation) to offset the costs of its administration and oversight of the Agreement, and pays one half of the transaction's closing costs (BHE's share is estimated to be approximately $250,000). The charter municipalities agree to extend their existing contracts with PERC to 2018; the tipping fee formula remains the same, and the charter municipalities continue to commit to provide in the aggregate 155,000 tons of waste per year.[3]

PERC, BHE and the MRC share equally PERC's net revenues after debt service and all costs of operations, including all required reserves, are paid (PERC's return on investment comes out of its one-third share). BHE's cost savings come from its one-third share of PERC's net revenues. The rates in its PERC PPA remain unchanged. In its filing, BHE estimated the net present value (NPV) of its share of the PERC rebates to be approximately $47.8 million; this estimate does not include the potential cost to BHE of the stock warrants.

On July 18, 1997, the Commission issued a Notice of Proceeding and Opportunity for Intervention. The Public Advocate, Industrial Energy Consumers Group (IECG), the MRC, and the City of Ellsworth and Town of Pittsfield filed petitions for intervention. By Procedural Order issued July 31, 1997, the Examiner granted the petitions. On August 18, 1997, the Public Advocate filed the testimony of Brian Abbanat. Mr. Abbanat concluded that the Agreement is likely to be substantially less beneficial than the Company projects, but that its NPV savings are positive under a set of cautious assumptions.

On August 21, 1997, the Commission held a hearing in this matter. During the hearing, parties cross-examined BHE's and the Public Advocate's witnesses and presented oral argument. All

---

[1]The interest earned from the reserve account, as well as the $10 million at the end of the PPA, will be equally distributed among BHE, PERC and the MRC.

[2]BHE also has an option allowing it to pay cash for the difference between market price and the exercise price of $7 per share.

[3]If this condition is not met, PERC has the option of cancelling all contracts with the charter municipalities.

parties supported approval of the Agreement; however, the Public Advocate and IECG expressed caution that the Agreement's savings may be significantly less than BHE's projections, and Ellsworth and Pittsfield proposed that the Commission include a waste tonnage requirement as a condition of approval.

On August 25, 1997, the Commission deliberated this matter and voted to deny certification of the Agreement because of the unlimited ratepayer exposure to costs that could arise from the exercise of the stock warrants. On August 26, 1997, BHE amended its petition to cap ratepayers' exposure to the cost of the warrants. Specifically, BHE limited ratepayer costs to the difference between the higher of $15.00 per share or the book value per share at the time the warrants are exercised and the $7.00 exercise price. The Company would not recover any costs above the cap from ratepayers.

On August 27, 1997, BHE filed a letter stating that, as a result of FAME concerns, the Agreement would include the following modifications:

- the $8 million up front payment is reduced to $6 million;
- the $2 million in follow-up payments is increased to $4 million paid in equal installments over 4 years;
- additional reserve accounts would be created;
- 15% of the annual distribution to PERC and the MRC would be held back by FAME for additional debt service reserve;
- PERC owner KTI would provide an additional $3 million corporate guarantee as an additional source of debt service reserve.

On August 27, 1997, the Commission issued its Order (Part I)[4] in this proceeding, certifying the Agreement as amended subject to a waste tonnage requirement. Specifically, we conditioned our approval of the Agreement on municipality commitments, by the closing of the transaction, to provide 175,000 tons of waste per year through 2018 at tipping fees comparable to those that would be produced under the existing charter municipality formula.

On September 2, 1997, BHE filed for reconsideration of the tonnage condition, stating that contractual requirements and time constraints would make it impossible to satisfy the condition.

[4]In our Order (Part I), we stated our findings and decisions; in this Order (Part II), we explain our reasons for those decisions.

BHE requested that the Commission modify its tonnage requirement to 88,000 per year. On September 8, 1997, the Public Advocate filed a response to BHE's petition for reconsideration, proposing that the Commission condition approval on a PERC commitment that BHE would be held economically harmless if PERC receives less than 155,000 tons of waste. On September 12, 1997, BHE filed a reply to the Public Advocate's proposal, stating that such a condition may cause the entire transaction to unravel.

On September 17, 1997, the Commission issued an Order on Reconsideration. The Commission declined to adopt the Public Advocate's proposal and reconsidered its original 175,000 ton per year requirement. The Commission imposed a 101,000 ton per year requirement and further conditioned its approval on inclusion of a provision in the new charter municipality contracts substantially similar to a provision in existing contracts designed to ensure a minimum aggregate delivery of 155,000 tons of waste annually.

III. STATUTORY AND OTHER REQUIREMENTS

The certification of the Agreement is before the Commission pursuant to 35-A M.R.S.A. § 3156. A Commission certificate of approval is required for FAME to finance the approximately $50 million loan to PERC. 10 M.R.S.A. § 963-A(7-A). Under the provisions of section 3156, the Commission may issue a certificate only if its finds:

1. The Agreement with assistance in financing to be provided by FAME will provide near-term benefits to BHE's ratepayers that will be reflected in rates;

2. Potential future adverse impacts associated with the Agreement are not likely to be disproportionate to near-term gains;

3. The Agreement does not have as a necessary or probable consequence the permanent cessation of operations of a qualifying facility with a capacity of more than 50 MW;

4. The Agreement is consistent with the Maine Energy Policy Act, 35-A M.R.S.A. § 3191; and

5. The Agreement will not adversely impact the availability of a diverse and reliable mix of energy resources and will not significantly reduce the long-term resources available to BHE.

If the Commission certifies the Agreement, the statute specifies the Commission may not disallow the recovery of BHE's costs incurred under the Agreement, including costs projected to be paid to PERC. Additionally, the statute requires the Commission to take all reasonable action to ensure that amounts required to be paid under the Agreement are available. *Id.*

In addition to these statutory requirements, FAME, as a condition of its approval, has required BHE to provide a corporate guarantee of the FAME-financed $50 million PERC loan. In order to proceed with the transaction, FAME seeks a Commission statement that it will allow any BHE costs incurred as a result of the guarantee to be recovered in rates.[5] FAME also requires a Commission statement that BHE's costs under the PERC PPA will not be disallowed from rates.

BHE has indicated that, to go forward with the Agreement, it seeks a general statement that the Commission will allow a regulatory asset to be created for the $10 million payments and any associated costs, and that any costs of the stock warrants up to the cap will be recoverable in rates and that a regulatory asset may be created for those costs.

IV. DISCUSSION

The Legislature authorized FAME to finance rate stabilization agreements in an effort to lower electric utility costs and minimize rates. By making relatively low cost funds available, the Legislature sought to facilitate negotiations to lower the costs of QF contracts. In the more typical case, the utility uses the FAME financed funds to buy out or buy down a QF contract with cost savings deriving from lower contract payments. In the instant case, however, FAME financed funds will be provided to PERC and the rates under the PERC PPA will remain unchanged. BHE’s costs savings comes from its one-third share of PERC’s net revenues. The Agreement was structured in this manner to align the interests of PERC, the charter municipalities, and BHE in the efficient operation of the facility. As a result of its structure, however, the savings associated with the Agreement will be a function of PERC’s revenues and costs over the next 18 years; this creates unusual risks and uncertainties that must be analyzed in assessing the potential for ratepayer benefits.

Our analysis of the economics of the Agreement indicates that it can be reasonably expected to produce positive NPV savings over a range of future scenarios, but that the savings are likely to be significantly less than those projected by BHE.[6]

[5]BHE will have to obtain specific Commission approval of the guarantee, as well as the financing of the $10 million and the issuance of the stock warrants. 35-A M.R.S.A. § 902.

[6]Because the rates in the PERC PPA are significantly above market

The amount of savings are particularly sensitive to tipping fee revenue, stock warrant costs, and PERC's capital and operating expenses, making the level of savings difficult to estimate. FAME’s requirement that BHE guarantee the loan to PERC adds additional risk that must be considered in the analysis of the Agreement. We discuss these uncertainties and risks below.

Due to the Agreement’s sensitivity to tipping fee revenue, a requirement that municipalities make long term commitments to provide a substantial amount of waste tonnage by the closing of the transaction is necessary to provide some level of assurance that ratepayers will benefit from the Agreement. We do not, however, wish to impose a requirement that cannot reasonably be satisfied; this could result in ratepayers losing the benefits of the Agreement. On balance, we find that a tonnage requirement of 101,000 tons per year[7] through 2018 at tipping fees comparable to those under the existing charter municipality formula, together with a provision in the new contracts maintaining the collective commitment to deliver 155,000 tons of waste annually, provide an enhanced level of assurance that ratepayer benefits will materialize without unnecessarily jeopardizing the savings under Agreement.

The stock warrant provision is another aspect of the Agreement that creates significant ratepayer risk and uncertainty. The warrants may be exercised at a price of $7.00 per share over a 10-year period. Although BHE's stock currently trades at around $5.50 per share, its book value is approximately $15.00 per share and, as recently as 1996, BHE's stock price was $12.50 per share. If BHE's stock price has a strong rebound sometime over the next 10 years, the benefits of the Agreement will diminish. Moreover, as initially proposed by BHE, the stock warrant provision placed unlimited cost exposure on ratepayers and created substantial uncertainty about the savings from the Agreement. By amending its petition to cap ratepayers cost exposure at the difference between the higher of $15 per share or book value (at the time of the warrants are exercised) and the exercise price, BHE has reduced the uncertainty of this aspect of the Agreement to an acceptable level.

---

rates, substantial ratepayer savings would occur if the facility ceased operation in the future. If the evidence revealed a reasonable likelihood that this might occur, the merits of the Agreement would be seriously in doubt. However, there is no evidence that suggests the facility will cease operation so as to relieve to Company of it contractual obligations.

[7]This tonnage requirement represents 58% of the waste that charter municipalities currently provide.

As stated above, the projected savings are also sensitive to PERC's capital and operating expenditures. BHE's savings estimates are based on projections that PERC's costs of operation will generally escalate at the same rate that they have historically. However, as the PERC facility ages and equipment reaches the end of expected service lives, it is reasonable to expect that PERC's costs will increase over past expenditures. Nevertheless, our analysis shows that even if PERC's costs escalate at significantly higher rates than projected, the Agreement is still reasonably likely to produce savings for ratepayers. Moreover, under the charter municipality contracts, the municipalities are responsible for 80% to 85% of any changes in ash disposal costs, and costs (above $100,000) resulting from changes in laws or regulations. For these reasons, ratepayers' risk deriving from possible cost increases to PERC's operation are not likely to result in the Agreement's producing negative savings.

Finally, the BHE corporate guarantee of the FAME-financed loan to PERC adds to the risk of the Agreement. If PERC defaults, BHE and its ratepayers would be responsible for the remaining loan payments. However, the risk presented by the guarantee is manageable and does not cause us to reject the Agreement. Under the Agreement, all revenues (from both tipping fees and the PPA) are paid to a trustee. The trustee's first obligation is to pay the debt service on the FAME loan. As a result, as long as the PERC facility operates, the trustee should receive revenues that are more than sufficient to pay the debt service.[8] For this reason, the only circumstance under which BHE would be required to discharge its obligations under the loan guarantee is if the PERC facility ceases to operate or operates at significantly less output than has occurred historically. If this occurred, BHE would be relieved of all or a significant part of its approximately $20 million per year PERC PPA payments. Although reductions in PPA costs are not directly relevant to the economic analysis of the Agreement (because the facility's operational problems would presumably occur regardless of the existence of the Agreement), it does indicate that ratepayer hardship from the guarantee would be more than offset from lower PPA costs that should simultaneously occur. Additionally, the Agreement as amended provides that the $10 million in BHE payments and 15% of PERC's and the MRC's annual distribution (up to $5 million) will be held in a debt service reserve account. These provisions further reduce the risk of BHE's guarantee of the PERC loan.

[8] PERC is expected to receive over $20 million a year from its PPA and over $14 million a year from tipping fees. Its debt service is expected to be approximately $4 million a year.

Having analyzed the Agreement's cost savings, uncertainties, and risks under a variety of future scenarios, we now address the required statutory findings. As stated above, we find that the Agreement is reasonably likely to result in some level of positive net present value savings over its 20-year term. We will incorporate a reasonable projection of these savings in our pending BHE rate proceeding. Accordingly, as required by 35-A M.R.S.A. § 3156(1) and (2), we find that:

- The Agreement, with financing assistance provided by FAME, will provide near-term benefits to BHE's ratepayers that will be reflected in rates; and

- Potential future adverse impacts associated with the Agreement are not likely to be disproportionate to near-term gains.

Because the Agreement does not change the terms of the PERC PPA, we make the following findings as required by 35-A M.R.S.A. § 3156(3)(4) and (5):

- The Agreement does not have as a necessary or probable consequence the permanent cessation of operations of a qualifying facility with a capacity of more than 50 MW;

- The Agreement is consistent with the Maine Energy Policy Act, 35-A M.R.S.A. § 3191; and

- The Agreement will not adversely impact the availability of a diverse and reliable mix of electric energy resources and will not significantly reduce the long-term resources available to BHE.

In addition to these statutorily required findings, we find that a BHE guarantee of the FAME-financed loan to PERC is reasonable as part of this transaction and will approve such a guarantee in the context of a BHE filing for approval under 35-A M.R.S.A. § 902. To the extent BHE incurs costs pursuant to such a guarantee, they will be considered costs under the terms of the Agreement and thus will be recovered in rates pursuant to section 3156. In addition, we find that the costs to BHE of its PERC PPA will continue to be recovered in rates and not be subject to disallowance. Also consistent with section 3156, we will allow BHE to establish a regulatory asset for the cost of its $10 million payments under the Agreement, as well as the cost of the stock warrants up to the cap; these costs will be recoverable in rates. The details of the regulatory assets and required amortizations will be determined upon BHE filing for appropriate accounting orders and financing approval under 35-A M.R.S.A. § 902.

For the reasons discussed in this Order, we issue a certificate of approval for the Agreement subject to the conditions as stated in this Order and in our Order on Reconsideration.

Dated at Augusta, Maine, this2912 10th day of OctoberSeptember, 1997.

BY ORDER OF THE COMMISSION

Dennis Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Hunt

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of adjudicatory proceedings are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 6(N) of the Commission's Rules of Practice and Procedure (65-407 C.M.R.11) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which consideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.